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IN THE

Supreme Court of the United States

October Term, 1970

No. 675

COMMERCIAL SOLVENTS CORPORATION,

Petitioner,

v.

THE UNITED STATES.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioner, Commercial Solvents Corporation, prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Claims entered in this proceeding on June 12, 1970.

Opinion Below

The opinion of the United States Court of Claims (Appendix B, *infra*), is reported at — F. 2d —.

Jurisdiction

The judgment of the United States Court of Claims was dated June 12, 1970 and was entered on June 12, 1970.

The jurisdiction of the Court of Claims was based on Section 6532(a) I.R.C. and the jurisdiction of this Court is invoked under 28 U.S.C. § 1255(1).

Questions Presented

1. Whether petitioner could amend its timely petition in the United States Court of Claims to claim a refund, based upon an original claim filed with the Internal Revenue Service, in an amount greater than the amount stated in such petition, for the reason that the greater amount was determinable by the Commissioner of Internal Revenue in the administrative processing of the original claim for refund.

2. Whether the petitioner's right to take the output produced by a manufacturing plant, which right was protected by the rules of equity of the jurisdiction whose law governed the interpretation of the contract, constituted an equitable interest in that plant, and whether the sale of that right gave rise to capital gains.

Statutory Provisions Involved

This case involves section 3772(a)(4), section 322(b)(2)(A), section 322(b)(3), and section 117(a)(1), all of the Internal Revenue Code of 1939. The pertinent provisions appear in Appendix A hereto at page 1a.

Statement of Facts

On December 30, 1948 petitioner entered into an agreement with Mathieson Chemical Corporation (Mathieson) cancelling an executory contract executed on November 10, 1947 which had given petitioner the exclusive right to the entire output of Mathieson's Lake Charles anhydrous ammonia plant. In accordance with that agreement, Mathieson paid petitioner $500,000 in 1948, $300,000 in each of the years 1949 to 1954, and $150,000 in each of the years 1955 and 1956. Petitioner timely reported $500,000 in income

on its 1948 Federal income tax return and $300,000 in income on its 1949 income tax return. By an amended 1948 return filed on July 13, 1951, petitioner included in 1948 income the total sum of 2.6 million dollars, representing the aggregate of all such payments, as ordinary income. On July 17, 1951 petitioner filed a claim for refund based on a contention that $300,000 was erroneously included in 1949 income. This refund claim was allowed on or about May 7, 1958.

On June 30, 1954, petitioner timely filed a claim for refund with the Director of Internal Revenue for $338,000 or such additional sums as may by law be due, together with interest thereon, on the ground that the total payments from Mathieson reported in the 1948 amended return were not ordinary income but represented long term capital gains. As part of that claim for refund, petitioner attached a statement which included a list of all the payments from Mathieson, including the times such payments were due, as set forth above. The claim was formally rejected on December 18, 1961, four years after the Internal Revenue Service had ruled that the payor (Mathieson) should deduct the payments in the respective years during which such payments were due. Reference is made to the Court of Claims' findings Nos. 23 and 24, at pages 30 and 31 of the printed opinion (Appendix B, p. 41a, *infra*), which are the result of a discovery proceeding brought by petitioner.

Thereafter on December 13, 1963, petitioner commenced suit in the United States Court of Claims, asserting the capital gains issue; and by amendment dated September 13, 1965 petitioner asserted that the respective payments were not taxable until they were due from Mathieson.

The petition and amended petition were dismissed on June 12, 1970.

Reasons for Granting the Writ.

The decision of the United States Court of Claims conflicts with the decision of the United States Court of Appeals, Second Circuit, in *St. Joseph Lead Co., Inc. v. United States* (C.A. 2, 1962) 299 F. 2d 348, with respect to the question whether petitioner was entitled to relief on the amended petition.

The decision of the court below is also in conflict with the decision of the United States Court of Appeals, Second Circuit, in *Commissioner v. Ferrer* (C.A. 2, 1962) 304 F. 2d 125, and the decision of the United States Court of Appeals, Ninth Circuit, in *Hollywood Baseball Association* (C.A. 9, 1965) 352 F. 2d 350 on the capital gains issue.

The questions presented are of importance in the administration of the federal tax laws. Settlement of such questions by this Court would be in the public interest, since petitioner's case is representative of problems facing many taxpayers.

The first question on which the Second Circuit and the Court of Claims are divided results from a practice of the Internal Revenue Service to apply the tax laws in an inconsistent manner to different taxpayers. Where, as here, the inconsistent treatment is applied to two different taxpayers who are parties to a single transaction, the result is especially troublesome.

In its opinion, the Court of Claims did not discuss the Second Circuit decision in *St. Joseph Lead Co., Inc.* although that case was fully briefed by petitioner. There an amended claim for refund was filed after suit was commenced in the District Court based upon rejection of St. Joseph Lead Company's original claim. The amended claim, which was based upon errors discovered by the Internal Revenue Service in processing the original claim, and which was filed after the period of limitations, was denied by the Commissioner of Internal Revenue. Thereupon the tax-

payer moved for leave to amend its complaint in the District Court and such leave was granted. The government's sole defense in the lower court and its sole argument on appeal was that the attempt to obtain a refund based on errors discovered by it was barred by the statute of limitations. The Second Circuit, affirming the decision below, referred to its decision in *Pink v. United States* (C.A. 2, 1939), 105 F. 2d 183, from which it quoted:

> "Whether a new ground of recovery may be introduced after the statute has run by amending a pending claim filed in time depends upon the facts which an investigation of the original claim would disclose. Where the facts upon which the amendments is based would necessarily have been ascertained by the commissioner in determining the merits of the original claim, the amendment is proper. The rule is otherwise when the amendment requires the examination of new matters which would not have been disclosed by an investigation of the original claim."

The Second Circuit therefore held, in that case, that the amended claim related back to the time the original claim was filed and the original action brought.

The discussion by the court below at pages 8 through 10 of the printed opinion (Appendix B, p. 13a) disregards the decision of the Second Circuit in *St. Joseph Lead Co., Inc.*, *supra*. The court discussed the variance rule and the question of intent with which it dealt in its decision in *Union Pacific Railroad Co.* v. *United States* (Ct. Cls., 1968), 389 F. 2d 437. In that case the taxpayer raised seven new grounds for refund in an amended petition to the court which were not included in any timely claim for refund and were barred by the statute of limitations. The decision of the Supreme Court in *Angelus Milling Co.* v. *Commissioner* (1945), 325 U.S. 293, dealt with a comparable problem. There incomplete and confusing claims for refund of taxes paid on the processing of wheat were filed. The facts were

not adequately presented nor was the Commissioner able to develop them clearly. In both cases, therefore, the claimed refunds were not allowed.

These cases are distinguishable from the present matter where all of the facts and issues were in the file of the examining agent prior to the time he rejected the claim. The court noted at pages 6 and 7 of its opinion (Appendix B, p. 10a): "Defendant further acknowledges that the Internal Revenue Service had knowledge of these facts, and that it considered the accrual question, although not in connection with the refund claim". Here the petitioner presented all the facts and claimed an adequate amount of refund in its original claim. No amendment was necessary to enlarge upon the facts or the amount of refund claimed. The amendment to the petition presented no new facts—all of them having been ascertained by the Internal Revenue Service during the examination of the original claim and even prior thereto in its consideration of Mathieson's tax returns.

The opinion of the Court of Claims in the instant case is thus in conflict with the decision of the Second Circuit in *St. Joseph Lead Co., Inc. v. United States, supra.*

The second question upon which the Court of Claims is in conflict with both the Second Circuit and the Ninth Circuit rests upon the conclusion by the Court of Claims that the original contract did not constitute a capital asset in petitioner's hands, although it recognized that the payments were the result of a sale or exchange of property. The Court of Claims was in conflict with the Second Circuit and the Ninth Circuit when it disregarded the conclusions in these cases to decide the issue in accordance with *Coleman v. United States* (Ct. Cls., 1967), 388 F. 2d 337, on the ground that all that was involved was a surrender of a naked contract right to obtain periodic receipts of ordinary income.

The facts in the *Coleman* case are distinguishable from the facts in the present case. The contract there was a pure purchase agreement for gas which the purchaser had the right to use or sell. That contract did not give the taxpayer an "estate" or "encumbrance" as did the rights which were disposed of in the *Ferrer case*. It is noteworthy that the capital gains issue was raised in *Coleman* as an alternative to a percentage depletion issue.

The Second Circuit decision in *Ferrer, supra*, involved consideration of the disposition of a group of rights in a play. The rights were divisible into two groups. The group of rights which were characterized as a "lease" of the exclusive right to produce the play and as the "negative power" to prevent disposition of motion picture and other rights until after production of the play were found to be capital assets. The rights to a portion of the motion picture proceeds and other similar rights were held not to be capital assets.

Thus, in the *Ferrer* case, the *sale* of the contract to produce the play was held to be the *sale* of a capital asset, and capital gain was derived from the proceeds of that *sale*. Both the right to produce the play and petitioner's right to take the production of the Mathieson plant could have resulted in the receipt of ordinary income only if the rights had not been sold.

Nevertheless, petitioner's proprietary interest in Mathieson's plant was as great as Ferrer's proprietary interest in the play. Although neither petitioner nor Ferrer had any color of title to the property involved, each had the exclusive right to enforce the use of the property to his benefit even to the exclusion of the legal title holder by invoking the protection of equity. The "estate" or "encumbrance" of Ferrer in the play was equal to the "estate" or "encumbrance" held by petitioner in Mathieson's plant. The Second Circuit recognized the extent of Ferrer's "estate"—the court below failed to apply the same rule of law to the case at bar.

The argument unsuccessfully raised by the Commissioner of Internal Revenue in the appeal of the Tax Court's decision in *Hollywood Baseball Association* to the Ninth Circuit was identical to the government's argument here which was sustained by the Court of Claims. There the contention was made by the government that payment from the sale of the right to play baseball in certain areas was merely in lieu of future profits. The Ninth Circuit held the payment to be proceeds from the sale of a capital asset, thus affirming the Tax Court which had relied upon this Court's definition of a capital asset in *Commissioner* v. *Gillette Motor Co.*, 364 U.S., 130, 134-135, where the distinction was drawn between property as a capital asset and the right to the use of property as giving rise to rent. In the present case, the Court of Claims was dealing with property and not the right to use property.

The Ninth Circuit recognized that the capital asset, the right to play baseball in an exclusive area as a member of a league, included other rights which generated ordinary income. These were the right to sell admissions, concession items, and broadcast and television privileges. Thus the Ninth Circuit recognized the difference between sale of the "tree" and sale of the "fruit". It also recognized the distinction between a property and the right to the use of property.

The opinion of the Court of Claims is contrary to its Findings of Fact 18 and 19 which can only lead to the conclusion that the contract was a capital asset similar to that contract adjudicated by the Second Circuit in *Ferrer* and by the Ninth Circuit in *Hollywood Baseball Association*.

On this question, therefore, the decision of the Court of Claims is in conflict with the decisions of the Courts of Appeals for the Second and Ninth Circuits.

Accordingly, it is respectfully submitted, the fundamental reason for granting the writ lies in the fact that the issues are continuing and affect a large number of taxpayers. The courts have reached diametricallly opposite conclusions in the consideration of the tax consequences of similar transactions. It is believed that resolution of these matters is in the best interests of the government and of taxpayers generally.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

EDWARD M. TAYLOR
Counsel for Petitioner

APPENDIX A

(Statutory Provisions Involved)

SEC. 3772. SUITS FOR REFUND.

(a) *Limitations*—

(1) *Claim.* No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

SEC. 322. REFUNDS AND CREDITS.

(b) *Limitation on Allowance*—

(2) *Limit on amount of credit or refund.* The amount of the credit or refund shall not exceed the portion of the tax paid—

(A) If a return was filed by the taxpayer, and the claim was filed within three years from the time the return was filed, during the three years immediately preceding the filing of the claim.

(3) *Exceptions in the case of waivers.* If both the Commissioner and the taxpayer have, within the period prescribed in paragraph (1) for the filing of a claim for credit or refund, agreed in writing under the provisions of section 276(b) to extend beyond the period prescribed in section 275 the time within which the Commissioner may make an assessment, the period within which a claim for credit or refund may be filed, or credit or refund allowed or made

if no claim is filed, shall be the period within which the Commissioner may make an assessment pursuant to such agreement or any extension thereof, and six months thereafter, except that the provisions of paragraph (1) shall apply to any claim filed, or credit or refund allowed or made, before the execution of such agreement. The amount of the credit or refund shall not exceed the total of the portions of tax paid (A) during the two years immediately preceding the execution of such agreement, or, if such agreement was executed within three years from the time the return was filed, during the three years immediately preceding the execution of such agreement, (B) after the execution of the agreement and before the expiration of the period within which the Commissioner might make an assessment pursuant to such agreement or any extension thereof, and (C) during six months after the expiration of such period, except that the provisions of paragraph (2) shall apply to any claim filed, or credit or refund allowed, before the execution of the agreement. Notwithstanding the foregoing provisions of this paragraph, the period within which a claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, shall not expire prior to two years after the time the tax was paid, but if a claim is filed, or credit or refund allowed or made if no claim is filed, more than six months after the expiration of the period within which the Commissioner may make an assessment pursuant to such agreement or any extension thereof, the amount of the credit or refund shall not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim, or, if no claim is filed, immediately preceding the allowance of the credit or refund.

Appendix A

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.* As used in this chapter—

(1) *Capital assets.* The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(B) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), or real property used in his trade or business;

(C) a copyright; a literary, musical, or artistic composition; or similar property, held by—

(i) a taxpayer whose personal efforts created such property, or

(ii) a taxpayer in whose hands the basis of of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property; or

(D) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

APPENDIX B

(Decision of the Court of Claims)

IN THE UNITED STATES COURT OF CLAIMS

No. 361-63

(Decided June 12, 1970)

COMMERCIAL SOLVENTS CORPORATION v. THE UNITED STATES

Jay O. Kramer, attorney of record, for plaintiff. *Morton M. Cohen*, of counsel.

Gilbert W. Rubloff, with whom was *Assistant Attorney General Johnnie M. Walters*, for defendant. *Philip R. Miller* and *Joseph Kovner*, of counsel.

Before COWEN, *Chief Judge*, LARAMORE, DURFEE, DAVIS, COLLINS, SKELTON, and NICHOLS, *Judges*.

OPINION*

LARAMORE, *Judge*, delivered the opinion of the court:

This is an action to recover an alleged overpayment of Federal income tax paid for the tax year 1948, plus interest as provided by law. The controversy arises from a transaction whereby plaintiff-taxpayer agreed to receive a sum certain payable in installments in cancellation of an executory contract. The issues before us involve (1) whether

* We are indebted to Trial Commissioner Lloyd Fletcher for his findings of fact and recommended opinion, with respect to the capital gain issue, which have been adopted in their near entirety.

plaintiff may claim a refund in this suit on grounds relating to the appropriate year or years for reporting taxable gain, which grounds were not included in plaintiff's refund claim but were advanced for the first time in plaintiff's amended petition, and (2) whether such gain is taxable as ordinary income or capital gain.[1] We hold that plaintiff is not entitled to recover; the pertainent facts incident to our holding follow.

Plaintiff, Commercial Solvents Corporation, is engaged in the manufacture, import, export, sale, and purchase of chemicals, solvents, drugs, fertilizers, and related by-products. During 1947, it operated a plant in Sterlington, Louisiana, where it produced anhydrous ammonia from natural gas. The output of the Sterlington plant was sold by plaintiff to fertilizer manufacturers in the Gulf States where it had developed a marketing network.

In January 1947, the Mathieson Chemical Corporation (Mathieson) had leased from the United States for ten years an ammonia plant located at Lake Charles, Louisiana.[2] At that time, Mathieson had little experience in the fertilizer industry, and its management had no specific plans for the use of the Lake Charles plant.

At about the same time, plaintiff's officers learned of successful experiments in applying anhydrous ammonia directly to the soil as a fertilizer. They correctly anticipated that this new development would result in a greatly in-

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[1] The original petition asserted, as the sole ground for recovery, plaintiff's contention that the amounts received and receivable under the cancellation agreement represented proceeds from the sale of a capital asset rather than ordinary income. Later, however, the petition was amended to reflect plaintiff's additional contentions to the effect that payments should be taxed as and when received by plaintiff rather than accrued in their entirety in 1948. See p. 6, *infra*.

[2] In August 1948, the Government, acting through the War Assets Administration, approved the sale of the Lake Charles plant to Mathieson.

creased demand for anhydrous ammonia. Since plaintiff's Sterlington plant was operating at full capacity, plaintiff's representatives approached officials of Mathieson for the purpose of discussing the possibility of plaintiff's purchasing and distributing the anhydrous ammonia production from Mathieson's Lake Charles plant.

As a result of these discussions, plaintiff and Mathieson entered into a contract on November 10, 1947, whereby Mathieson agreed to sell to plaintiff the entire anhydrous ammonia production from its Lake Charles plant, except for a reserved quantity not to exceed ten tons per day, for a period of eight years commencing July 1, 1949. Under the contract, plaintiff was to pay Mathieson the market price for all anhydrous ammonia purchased less deduction for (1) $2.50 per ton for freight equalization, (2) $2.50 per ton of ammonia shipped in plaintiff's tank cars, and (3) a commission of five percent of the market price, after deducting the allowances for freight equalization and for use of plaintiff's tank cars. Plaintiff intended to sell the major portion of this anhydrous ammonia as fertilizer for direct application to the soil by farmers in the same way and under the same method of distribution which plaintiff was then using to sell the anhydrous ammonia production of its Sterlington plant.

In April 1948, Thomas Nichols became the new president of Mathieson, and J. C. Leppart assumed the executive vice-presidency of that company. They immediately reviewed all outstanding contracts in the Mathieson files, including the executory contract with plaintiff. They concluded that the contract with plaintiff was improvident and undesirable for Mathieson in that it deprived Mathieson of the right to use or otherwise dispose of in more profitable ways the anhydrous ammonia production from its Lake Charles plan for a substantial period of eight years. Also, from Mathieson's point of view, they thought it important to prevent plaintiff from dominating the ammonia market in the Gulf States.

Accordingly, in September 1948, Nichols contacted plaintiff's president, Henry Perry (now deceased), and indicated that he desired to negotiate a cancellation of the executory contract before it became operative. For several months, the presidents of the two companies conducted frequent discussions in an effort to arrive at a mutually satisfactory basis for termination of the agreement. In the course of these discussions, both men had made independent estimates of plaintiff's projected earnings under the contract and, at least insofar as Nichols was concerned, he felt the most equitable method of terminating the contract would be for Mathieson to pay plaintiff an amount which, making certain assumptions, would be substantially equivalent to the profits which plaintiff would probably realize if the contract were fully performed. It is unclear whether Perry shared Nichols' method of approach in this regard. One of Perry's principal assistants, who was opposed to any cancellation or modification of the contract, believed that his president was simply uncomfortable in the face of Nichols' determined opposition to the contract and that the eventual figure agreed upon between the two presidents was, in Perry's view, merely an acceptable settlement of a difficult situation without specific correlation to plaintiff's anticipated profit.[3]

In any event, on December 30, 1948, the parties entered into an agreement canceling the 1947 contract. Under the terms of the cancellation agreement, Mathieson obligated itself to pay plaintiff $2.6 million in installments over an eight and one-half year period, $500,000 being payable upon execution of the agreement in 1948, $300,000 being payable on July 1 of each of the six succeeding years (1949-1954), and $150,000 being payable on July 1 of each of the final

[3] As stated below, the eventual settlement figure was 2.6 million dollars, whereas Perry's aide had estimated plaintiff's anticipated profits from the contract at nearly 4 million dollars.

two years (1955-1956). The installment payments agreed upon were paid by Mathieson to plaintiff substantially in accordance with the cancellation agreement.

In its 1948 Federal income tax return, plaintiff included as ordinary income the first payment of $500,000 which it had received from Mathieson on December 30, 1948. In its 1949 return, plaintiff treated the next Mathieson payment of $300,000 in the same way. However, on July 13, 1951, plaintiff filed an amended return for 1948 in which it included the entire amount paid and payable by Mathieson under the cancellation agreement as ordinary income. In a statement attached to the amended return, plaintiff explained that, by reason of a recent decision of the United States Court of Appeals for the Seventh Circuit in *Universal Oil Products Co.* v. *Campbell*, 181 F. 2d 451 (7th Cir., 1950), *cert. denied* 340 U.S. 850 (1950), it had concluded that the full amount payable under the cancellation contract should have been accrued for Federal income tax purposes in the year 1948.

The amended return increased plaintiff's tax liability for 1948 by $798,000, which amount was paid with interest. Shortly thereafter, plaintiff filed its claim for refund of 1949 tax on the ground that it had erroneously included in 1949 income the $300,000 payment received from Mathieson on July 1, 1949. That claim for refund of 1949 income tax was allowed and appropriate refund was made. Thereafter, of course, plaintiff did not include in its tax returns for subsequent years any of the Mathieson installment payments.

On June 30, 1954, plaintiff filed a timely claim for refund of an alleged overpayment of 1948 tax on the ground that the $2.6 million received or receivable from Mathieson under the cancellation agreement represented proceeds from the sale of a capital asset and, therefore, should be taxed to it as capital gain. Following an unusually long administrative proceeding before the Internal

Appendix B

Revenue Service, the claim for refund was formally rejected on December 18, 1961. Thereafter, on December 13, 1963, plaintiff filed its petition in this case asserting as its sole ground for recovery "that the amount of $2,600,000 receivable from Mathieson Chemical Corporation was not ordinary income but represented the proceeds from the sale of a capital asset."

Meanwhile, following an audit of plaintiff's tax returns for each of the years 1949-1956, the Commissioner of Internal Revenue asserted deficiencies in plaintiff's income taxes for four of those years, such deficiencies being unrelated to the issues here involved. Plaintiff contested those deficiencies in the Tax Court. Following the Tax Court's decision (42 T.C. 455) partially upholding the deficiencies, plaintiff appealed to the Second Circuit Court of Appeals. On May 26, 1965, the appeal was dismissed pursuant to a settlement by the parties. By virtue of the dismissal, no further deficiencies in plaintiff's taxes for the years 1951 and 1954-1956 could be asserted. At the time the settlement was reached, neither plaintiff's representatives, nor the Department of Justice, nor the Internal Revenue Service, knew that plaintiff would thereafter amend its petition in the instant action.

On September 13, 1965, plaintiff filed an amended petition in the pending action adding second and third causes of action, the effect of which was to challenge the propriety of reporting the entire gain in 1948. Prior to the time that the amended petition was filed, plaintiff's officers, employees, and representatives had made no statements or representations to the Internal Revenue Service indicating that plaintiff intended to, or did in fact, claim a refund of 1948 income tax on the grounds set forth in the second and third causes of action of its amended petition. At the time the amended petition was filed, all the years 1949 through 1956 were closed to further assessment.

Appendix B

I.

As earlier indicated, plaintiff's amended petition added second and third causes of action to the original petition's sole cause of action which asserted that the proceeds of the cancellation agreement constituted capital gain. The second cause of action asserted that "plaintiff incorrectly reported the entire sum of $2,600,000.00 in its amended Federal income tax return for the calendar year of 1948, instead of the sum of $500,000.00 actually received from Mathieson Chemical Corporation in that year." The third cause of action asserted that "on its amended U.S. corporation income tax return for the year 1948, filed July 13, 1951, taxpayer improperly changed its election to report the income from the installment method [which method was elected on plaintiff's timely original return] to the accrual method." The upshot of both additional causes of action was plaintiff's claim that, because the cancellation agreement proceeds were improperly reported in their entirety in 1948 rather than properly reported as and when received, an overpayment of 1948 taxes resulted entitling plaintiff to a refund thereof.

Plaintiff has admitted that in filing its refund claim and in pursuing it administratively, it did not intend to assert as grounds for recovery the positions set forth in the second and third causes of action of its amended petition. It says, however, that those causes of action are related and germane to, and stem from, the refund claim filed June 30, 1954. Also, the additional causes of action encompass no new or different facts other than those stated therein, and that such facts underlie the causes of action in the original petition and in plaintiff's amended petition.

Defendant does not dispute that the operative facts which underlie plaintiff's claim to capital gain treatment also relate to the questions now sought to be raised regarding the proper year in which the income should have been reported. Defendant further acknowledges that the In-

ternal Revenue Service had knowledge of these facts, and that it considered the accrual question, although not in connection with the refund claim. Defendant insists, however, that there is substantial variance between the refund claim and the amended petition to such extent that the second and third causes of action set forth in the amended petition may not be considered by this court. Defendant also asserts that the operative facts form a proper basis upon which to estop plaintiff from advancing the grounds for recovery contained in the second and third causes of action. We hold that defendant's position with respect to the substantial variance issue is well taken, hence we need not reach the estoppel issue.

Section 3772(a)(1) of the Internal Revenue Code of 1939, the statutory provision which governs the procedural question under review, provides that no refund suit shall be maintained in any court "until a claim for refund or credit has been duly filed with the Commissioner, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof." Treasury Regulations 111 (1939 Code), section 29.322-3 imparts, with respect to the relationship between the requisite elements of a refund claim and a later recovery, that:

> No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed prior to the expiration of such period. *The claim must set forth in detail each ground upon which a refund is claimed*, and facts sufficient to apprise the Commissioner of the exact basis thereof. * * *. [Emphasis added.]

Thus, it is seen that under the applicable regulations a refund claim must, as a matter of functional composition, depict with some particularity those grounds upon which a subsequent recovery might be granted.

Appendix B

In the judicial realm, the so-called variance rule recently was the subject of an extensive and detailed discussion by this court in *Union Pacific Railroad Co.* v. *United States*, 182 Ct. Cl. 103, 289 F. 2d 437 (1968). In *Union Pacific*, we stated with ample authority:

> It is an undisputed general rule that a ground for refund neither specifically raised by, nor comprised within the general langauage of, a timely formal or informal application for refund to the Internal Revenue Service cannot be considered by a court in which a suit for refund is subsequently initiated. *United States* v. *Felt & Tarrant Mfg. Co.*, 283 U.S. 269 (1931); *Real Estate-Land Title & Trust Co.* v. *United States*, 309 U.S. 13, 17-18 (1940); *International Curtis Marine Turbine Co.* v. *United States*, 74 Ct. Cl. 132, 56 F. 2d 708 (1932); *The Midvale Co.* v. *United States*, 133 Ct. Cl. 881, 138 F. Supp. 269 (1956); *Williamson* v. *United States*, 155 Ct. Cl. 279, 292 F. 2d 524 (1961). The rule that a taxpayer cannot present one ground for refund in its claim and a different ground in its petition is designed both to prevent surprise and to give adequate notice to the Service of the nature of the claim and the specific facts upon which it is predicated, thereby permitting and [sic] administrative investigation and determination. *United States* v. *Memphis Cotton Oil Co.*, 288 U.S. 62 (1933). In addition, the Commissioner is provided with an opportunity to correct any errors, and if disagreement remains, to limit the scope of any ensuing litigation to those issues which have been examined and which he is willing to defend. *Carmack* v. *Scofield*, 201 F. 2d 360, 362 (5th Cir. 1953); *Thompson* v. *United States*, 332 F. 2d 657, 660 (5th Cir. 1964); *Tucker* v. *Alexander*, 15 F. 2d 356 (8th Cir. 1926), *reversed on other grounds*, 275 U.S. 228 (1927). [182 Ct. Cl. at 108-109, 389 F. 2d at 442.]

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It is clear in the instant case that at no time during the entire administrative proceedings did the Internal Revenue Service have cause to believe that plaintiff claimed, or would claim, an additional refund of 1948 income tax based upon the alleged impropriety of taxing the entire gain in 1948. Indeed, it was plaintiff who requested such treatment, to which request the Service acceded. And it was not until the addition of the second and third causes of action in the 1965 amended petition that the Service was first put on notice *by plaintiff* of its claim that, contrary to its earlier requested treatment, the gain was not reportable in its entirety in 1948. What plaintiff purports to do by its amended petition is, we think, clearly without the limits of the variance rule as interpreted by the *Union Pacific* case.

Plaintiff reasons that its position is advanced by the congruence of operative facts underlying the three causes of action; this alone will not suffice. Implicit in plaintiff's argument is the imputing to the Service of constructive notice regarding all potential grounds for recovery issuing from a submitted fact situation, irrespective of the point in time at which a particular ground is actually advanced. Apparently plaintiff would impose upon the Service the insatiable burden of anticipating all grounds which plaintiff might, in fact, ultimately advance. The imposition of such a burden upon the Service is, in our view, contrary to the rationale underlying the variance rule, and inconsistent with fair administration of revenue collection and disbursement.[4]

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[4] Subject to the same objections is plaintiff's contention that its claim for a refund of $338,000 "or such additional sums as may by law be due" entitles it to belatedly advance the grounds comprising the second and third causes of action. *See, National Forge & Ordnance Co.* v. *United States*, 139 Ct. Cl. 204, 222, 151 F. Supp. 937, 941 (1957); *Electric Storage Battery Co.* v. *McCaughn*, 54 F. 2d 814 (E. D. Pa. 1931); *affirmed*, 63 F. 2d 715 (3d Cir. 1933).

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The possibility that the Service might, by its own devices, deduce from the submitted facts the ground ultimately advanced by the taxpayer is not enough to remedy the insufficiency in plaintiff's position. Neither is the insufficiency cured by the Service's consideration, as here, of the later-raised accrual question in a context only indirectly related to plaintiff's refund claim. The decisions of this court make clear the untenable nature of plaintiff's position. Particularly pertinent, again, is our recent *Union Pacific* decision in which we said:

> A taxpayer might obtain a recovery in his refund suit on a ground other than that specified in his claim if he can establish adequate notification to the Internal Revenue Service of an intention to claim a refund on that ground. Mere availability of the facts underlying a claim, however, is not enough to find that an intention to claim a refund has been communicated. In *American Radiator & Standard Sanitary Corp.* v. *United States*, 162 Ct. Cl. 106, 318 F. 2d 915 (1963), we said:
>
> > It is not enough that the Service have in its possession information from which it might deduce that the taxpayer is entitled to, or might desire, a refund; * * *. [162 Ct. Cl. at 114, 318 F. 2d at 920]
>
> The Supreme Court, in *Angelus Milling Co.* v. *Commissioner*, 325 U.S. 293 (1945), discussing a comparable problem, stated:
>
> > It is not enough that in some roundabout way the facts supporting the claim may have reached him. The Commissioner's attention should have been focused on the merits of the particular dis-

> pute. The evidence should be clear that the Commissioner understood the specific claim that was made * * *. [at 297-298]
>
> * * * [I]t is not enough that somewhere under the Commissioner's roof is the information which might enable him to pass on a claim for refund. [at 299]
>
> Neither the Commissioner nor his agents can be expected to ferret out any possible grounds for relief which a taxpayer might assert. Availability of information is not equivalent to notice that a claim is asserted based on that information. That claim must somehow be communicated to the Service. [103 Ct. Cl. at 113, 389 F. 2d at 444-445]

In the instant case, there can be little doubt that plaintiff failed in the administrative stage to claim a refund on a ground which raised the accrual issue, and thereby failed to properly put the Service on notice of its intention to advance such ground in a judicial forum. Accordingly, we hold that the grounds set forth in the second and third causes of action of plaintiff's amended petition constitute a substantial variance from its administrative refund claim, and, therefore, cannot provide the basis for a recovery here.

II.

Turning now to the ground for recovery advanced by plaintiff administratively and as a first cause of action in its petition, plaintiff contends that the original contract between Mathieson and plaintiff constituted a capital asset, the surrender of which gave rise to capital gain. Defendant responds that the cancellation of the original contract gave rise to ordinary income, rather than capital gain, because

the cancelled contract *did not* constitute a capital asset. Defendant's position is well taken.[5]

The question of whether the consideration received by a taxpayer for agreeing to the cancellation of a contract should be taxed as capital gain or as ordinary income has produced decisional turmoil likened to "some of the more arcane intricacies of medieval theology." Eustice, *Contract Rights, Capital Gain, and Assignment of Income—The Ferrer Case*, 20 Tax L. Rev. 1 (1964).[6]

The nature of the problem has been well stated by Judge Friendly in his landmark decision, *Commissioner* v. *Ferrer*, 304 F. 2d 125 (2d Cir., 1962), as follows:

> Section 117(a) of the 1939 Code, now § 1221 of the 1954 Code, 26 U.S.C.A. § 1221, tell us, not very illuminatingly, that " 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include" four (now five) types of property therein defined. However, it has long been settled that a taxpayer does not bring

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[5] Defendant explicitly conceded at oral argument that which was implicit in its brief, *i.e.*, the cancellation of the original contract in the instant case constituted a sale or exchange. Accordingly, our denial of capital gain treatment to plaintiff herein rests upon our conclusion that the original contract did not constitute a capital asset in plaintiff's hands. *Compare, United States Freight Co.* v. *United States*, 190 Ct. Cl. —, 422 F. 2d 887 (1970), wherein we held that assuming *arguendo* the contract involved constituted a capital asset, there was no sale or exchange, prerequisite to capital treatment.

[6] In addition to this excellent article by Professor Eustice, see also the equally sweeping discussions of this problem contained in Dean, *Capital Gain and Ordinary Income—Problems in Transmutation*, 24 N.Y.U. Inst. on Fed. Tax. 1291 (1966) and Chirelstein, *Capital Gain and the Sale of a Business Opportunity: The Income Tax Treatment of Contract Termination Payments*, 49 Minn. L. Rev. 1 (1964). The latter article, in particular, is valuable for its exhaustive analysis of all the significant decisions in this difficult area of tax law.

himself within the capital gains provision merely by fulfilling the simple syllogism that a contract normally constitutes "property," that he held a contract, and that his contract does not fall within a specified exclusion, C.I.R. v. Gillette Motor Transport, Inc., 364 U.S. 130, 134-135, 80 S.Ct. 1497, 4 L.Ed. 2d 1617 (1960); Surrey, Definitional Problems in Capital Gains Taxation, 69 Harv. L.Rev. 985, 988 (1956). This is easy enough; what is difficult, perhaps impossible, is to frame a positive definition of universal validity * * *. [304 F. 2d at 129].

Judge Friendly then proceeds to a careful analysis of most of the leading cases in this area, and summarizes his conclusions in the following widely quoted statement:

> One common characteristic of the group held to come within the capital gain provision is that the taxpayer had either what might be called an "estate" in (Golonsky, McCue, Metropolitan), or an "encumbrance" on (Ray), or an option to acquire an interest in (Dorman) property which, if itself held, would be a capital asset. In all these cases the taxpayer had something more than an opportunity, afforded by contract, to obtain periodic receipts of income, by dealing with another (Starr, Leh, General Artists, Pittston), or by rendering services (Holt), or by virtue of ownership of a larger "estate" (Hort, P. G. Lake). We are painfully aware of the deficiencies of any such attempt to define the wavering line even in this limited area, but it is the best we can do * * *. [304 F. 2d at 130-131].

The foregoing principles were applied by Judge Friendly to the facts before the court. He concluded that the taxpayer, actor Jose Ferrer, was entitled to capital gain

treatment for payments made to him in consideration of his surrendering a lease which he held to produce the play, *Monsieur Toulouse*, on stage, as well as for payments made to him for releasing his power under a contract with the playwright to prevent the presentation of the play as a motion picture, on radio, or television. However, Mr. Ferrer also received payments for the surrender of his rights to receive a percentage of any proceeds derived from the play's future production as a movie or on radio or television, and the court felt that those payments constituted ordinary income to Mr. Ferrer.

The essential reason for the court's conclusion that the payments made to Ferrer for surrender of his lease were entitled to capital gain treatment was that he had an "equitable interest" in the copyright of the play sufficient to enable him to enjoin the playwright from interfering with his production of the play. The same reasoning applied to the payments made to Ferrer for his release of the power to prevent production of the play as a movie, or on radio, or television. Since, however, he had no proprietary right in the movie, radio, or television rights themselves, the payments made to him for the surrender of a right to a percentage of profits from those sources constituted ordinary income.

Singularly enough, both parties to the present controversy rely on *Ferrer* as support for their respective positions. Pointing to the fact that, in the part of his opinion allowing capital gain treatment, Judge Friendly emphasized the importance of the availability of injunctive relief to the taxpayer, plaintiff asserts that such equitable relief was likewise available to it under the contract in question. The contract was to be interpreted under the laws of the State of New York, and plaintiff finds support for its suggestion of the availability of equitable relief in a decision by the New York Court of Appeals which would appear to permit the entry of a decree of specific performance for

breach of a contract such as the present one where, due to changing future market conditions, it would be impractical to ascertain damages for breach of contract in the normal way. See *St. Regis Paper Co.* v. *Santa Clara Lumber Co.*, 173 N.Y. 149, 65 N.E. 967 (1903); *cf.*, however, *Fox* v. *Fitzpatrick*, 190 N.Y. 259, 82 N.E. 1103 (1907).

The government, on the other hand, argues that the contractual rights which plaintiff acquired in 1947 and which it agreed to cancel in 1948, amounted to nothing more than an opportunity to obtain periodic receipts of income by dealing with another, and that, hence, the other facet of Judge Friendly's opinion in *Ferrer* is the one applicable here. Plaintiff has made a persuasive showing that, in the event of a breach of the contract by Mathieson, plaintiff could have obtained equitable relief in the form of a decree for specific performance. Bearing in mind the emphasis placed by Judge Friendly on the availability of such equitable relief as a major factor pointing to capital gain treatment of the termination proceeds, plaintiff's reliance on *Ferrer* is understandable. This reliance loses much of its persuasiveness, however, when it is recognized that the equitable relief potentially available to plaintiff would likely be based not upon a proprietary or equitable interest in Mathieson's plant or output, but rather upon the difficulty of ascertaining damages. Moreover, the argument advanced by plaintiff fails to take into account a recent decision of this court which, in our judgment, cannot satisfactorily be distinguished from the present case, and which requires a decision in favor of the defendant's contention that the Mathieson cancellation payments constituted ordinary income to plaintiff.

The case referred to is *Coleman* v. *United States*, 181 Ct. Cl. 982, 388 F. 2d 337 (1967). There, as here, the court was presented the question of whether payments made to a taxpayer in consideration of the cancellation of an existing contract resulted in capital gain or ordinary income. Under

the pre-existing agreement which was canceled, the taxpayer's predecessor in interest, Reliance Carbon Company, Inc., had agreed to purchase from The Shamrock Oil and Gas Corporation a stipulated quantity of residue gas (extracted by Shamrock from natural gas) and to construct a plant for utilizing such residue gas in the manufacture of carbon black. In addition, Reliance had the option to resell the residue gas to others rather than itself using it in its carbon black manufacturing process. Under the agreement, which terminated the pre-existing contract, Shamrock received the right to sell all of its residue gas to other persons, and agreed to pay Reliance a stipulated amount based on Shamrock's future gas production. In passing on the same contention as that made by plaintiff here, this court said:

> In our case, the contractual rights which the taxpayer disposed of in the transaction of November 19, 1952 were, first, the right to purchase residue gas from Shamrock on a priority basis under the gas sales agreement of October 1, 1935, as amended, and, second, the right to burn the entire quantity of purchased gas in the manufacture of carbon black, or to use a portion of such gas for the manufacture of carbon black and resell another portion to third persons if this seemed advantageous to the taxpayer. In other words, what the taxpayer had was "a naked contract right" to purchase gas and thereafter to process or resell the gas, thereby obtaining periodic receipts of ordinary income. *Cf. Commissioner* v. *Pittston Company*, 252 F. 2d 344, 348 (2nd Cir. 1958), *cert. den.* 357 U.S. 919 (1958).
>
> Even in the first *CBN* case, where a majority of the court held that the CBN Corporation had an economic interest in the gas in place under the new agreement of November 19, 1952 between Shamrock and the CBN Corporation, the court said that under

the previous gas sales agreement of October 1, 1935, as amended, between those parties, the CBN Corporation "was nothing more than a purchaser with certain priority rights of purchase" (164 Ct. Cl. at page 549, 328 F. 2d at page 321). The contractual rights of the present taxpayer under the gas sales agreement of October 1, 1935, as amended, between Shamrock and the taxpayer were exactly the same, in all substantial respects, as the rights of the CBN Corporation under the similar gas sales agreement of October 1, 1935, as amended, to which the CBN Corporation was a party. Therefore, under the pronouncements by the court in both the first *CBN* case and the second *CBN* case, the taxpayer did not have any interest in the gas itself, prior to delivery by Shamrock, under the gas sales agreement of October 1, 1935, as amended.

Accordingly, since the gas sales agreement of October 1, 1935, as amended, between the taxpayer and Shamrock merely conferred on the taxpayer "a naked contract right" to purchase gas and use it or resell it as a means of obtaining periodic receipts of ordinary income, and did not vest in the taxpayer an interest in property, the disposition of such right in the transaction of November 19, 1952 between Shamrock and the taxpayer did not involve the disposition by the taxpayer of a capital asset. [181 Ct. Cl. 993-994, 388 F. 2d 343]

Clearly, the present case cannot be distinguished from *Coleman* on the grounds of availability of injunctive or equitable relief in the one and a lack of such relief in the other. Under Texas law the original Reliance-Shamrock contract could have been specifically enforced just as under New York law the contract between plaintiff and Mathieson

could have been. See, for example, *American Refining Co. v. Tidal Western Oil Corp.* (Tex. Civ. App.), 264 S.W. 335 (1924), *writ of error denied*, 114 Tex. 583, 278 S.W. 1114 (1926).

Indeed, plaintiff makes no effort to distinguish *Coleman* on any such ground. Instead, plaintiff argues that *Coleman* differs from the present case because of the fact that the consideration payable to Reliance for the surrender of its contractual rights were dependent upon future production of gas by Shamrock, whereas the consideration payable to plaintiff by Mathieson was a fixed sum in no way related to, or dependent upon, Mathieson's future production and sale of ammonia. This is not an acceptable distinction.

Under the *Ferrer* decision itself, a determination of whether contract cancellation payments constitute ordinary income or capital gain cannot be made by looking simply at the method agreed upon by the contracting parties for arriving at the amount of compensation payable for the cancellation agreement. In resemblance to *Coleman*, the payments made to Mr. Ferrer for the release of his contractual rights were based upon (in addition to salary payments) a stipulated percentage of the net profits derived from distribution of the picture. Accordingly, plaintiff's argument in this respect would lead to the conclusion that *all* amounts received by Ferrer were taxable to him as ordinary income. The decision in *Ferrer*, however, is to the contrary, the court holding that part of Ferrer's receipts was capital gain and part was ordinary income. It is apparent, therefore, that the important consideration in this connection is the nature of the contract rights surrendered rather than the method of computing the payments for the cancellation.

Concluding, as we do, that *Coleman* controls the disposition of the capital gain issue, further discussion of the perplexing decisions referred to in *Ferrer* would merely lengthen this opinion to no useful purpose. Therefore, it is held that plaintiff's treatment of the Mathieson payments as ordinary income in both its original and amended 1948 tax returns was the correct treatment.

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In accordance with the above, plaintiff is not entitled to recover in this action, and its petitions are dismissed.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Lloyd Fletcher, and the briefs and argument of counsel, makes findings of fact as follows:

1. The plaintiff is a corporation organized and existing under and by virtue of the laws of the State of Maryland, with its principal offices at 245 Park Avenue, New York, New York 10016 [sic]. It is engaged in the manufacture, import, export, sale and purchase of chemicals, solvents, drugs, fertilizers, and all kinds of merchandise entering into the manufacture of same, and all products and by-products thereof. The company keeps its accounting records and files its tax returns on the accrual basis.

2. Mathieson Chemical Corporation (hereinafter referred to as Mathieson) was incorporated on August 13, 1892, in the State of Virginia, under the name of The Mathieson Alkali Works Inc. Mathieson changed its name to Mathieson Chemical Corporation on March 30, 1948. Since August 31, 1954, the company has been known as Olin Mathieson Chemical Corporation. Its principal office is located in New York City. This company also keeps its accounting records and files its tax returns on the accrual basis.

3. On January 10, 1947, Mathieson leased an ammonia plant at Lakes Charles, Louisiana, from the War Assets Administration of the United States Government for a period of ten years. The plant was constructed by the Government and operated by Mathieson during World War II for the production of synthetic ammonia and ammonium nitrate solution. During World War II it produced only anhydrous ammonia which was shipped to other plants for

conversion to nitric acid for explosives manufacture. At the time Mathieson leased the Lake Charles installation, it had no specific plans for the use of the plant's output. Unlike plaintiff, which in 1947 was producing anhydrous ammonia from natural gas at its plant located in Sterlington, Louisiana, and selling its production to fertilizer manufacturers in the Gulf States, Mathieson had but little experience in the fertilizer industry and had developed no marketing network in that area of the country.

In order to market the output of its Sterlington plant, plaintiff had set up a distribution system in 1947 under which local people, acting as middlemen, provided storage tanks, each holding about ten cars of ammonia. The installation of these storage tanks cost between $600,000 and $1,000,000. Plaintiff leased, financed, and subsidized these storage facilities as part of the distribution program enabling it to sell anhydrous ammonia, for fertilizer uses, to retailers in the southern part of the United States.

4. In early 1947, a member of the faculty of Mississippi State College published a paper wherein he reported successful experimentation with anhydrous ammonia as a direct fertilizer applicant to the soil. At this time, plaintiff's Sterlington plant was already operating at full capacity, and anticipating a greatly increased demand for anhydrous ammonia as a result of its new use, plaintiff's representatives approached Mathieson officials for the purpose of discussing the possibility of plaintiff purchasing and distributing the Lake Charles output.

5. On November 10, 1947, Mathieson and plaintiff entered into a contract whereby Mathieson agreed to sell to plaintiff for a period of eight years commencing July 1, 1949, the entire ammonia production of the Lake Charles plant, except for a quantity not to exceed ten tons per day. The agreement provided, *inter alia*, that the then current estimated production of the Lake Charles plant, averaged

over a calendar quarter, was 160 tons per day. Mathieson was permitted to increase the production over and above that estimate effective at the beginning of any calendar quarter by giving plaintiff 60 days' notice to that effect. Plaintiff had the option to purchase the increased production, but in the event it decided not to do so, Mathieson was free to sell or use the excess production for its own account. The agreement further provided that if plaintiff's total ammonia requirements for any calendar quarter averaged less than 300 tons per day, plaintiff could reduce its purchases for the next calendar quarter to not less than 50 percent of plaintiff's total requirements for such quarter, but in no event was plaintiff to purchase less than an average of 135 tons per day. As stated, Mathieson had the right to sell or use any such ammonia produced in one month and not purchased by plaintiff which was not in excess of the then current estimated production.

The contract further provided that upon delivery to the custody of a railroad of ammonia loaded in tank cars consigned to plaintiff, or its nominee, such delivery effectuated a sale of the ammonia and title thereto would pass to plaintiff at that point. Mathieson agreed to provide storage facilities for a maximum of 1,500 tons of ammonia.

It was also provided that plaintiff would pay Mathieson for all ammonia sold under the contract, F.O.B. seller's plant, loaded in tank cars, the market price per ton prevailing at time of shipment from Lake Charles less:

(a) $2.50 per ton for freight equalization;

(b) a commission of 5% of the market price after deducting the allowance for freight equalization; and

(c) $2.50 per ton for ammonia shipped in plaintiff's tank cars.

"Market price" was defined to mean the lowest price at which tank car quantities of ammonia were offered by

other private producers for sale under annual contracts in the territory east of the Rocky Mountains, but not below the price at which plaintiff offered such ammonia for sale to industrial consumers under annual contracts.

Plaintiff was required by the contract to furnish sufficient tank cars to ship the quantity of ammonia produced for sale thereunder, and Mathieson agreed, under stated conditions, to relinquish its leasehold rights to 50 ammonia tank cars if plaintiff, in turn, would lease the same.[1] Neither party could assign its rights or obligations under the contract without prior written consent of the other. Its provisions were to be construed under the laws of the State of New York.

This contract entitling plaintiff to purchase the major portion of Mathieson's production at the Lake Charles plant was a valuable right in plaintiff's hands. There were three potential elements of profit for plaintiff thereunder. These were:

(a) $2.50 per ton for freight equalization;

(b) a commission of 5% of the market price after deducting said allowance for freight equalization; and

(c) $2.50 per ton for any ammonia shipped in plaintiff's tank cars [2]

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[1] In December 1946, plaintiff had purchased 44 high pressure tank cars from the United States Government for $251,530.03, for use in transporting the anhydrous ammonia output of its Sterlington plant. All of these cars were of the same type that would have been used to transport the output of the Lake Charles plant if the contract had become operative. Plaintiff subsequently found it necessary to lease additional tank cars to accommodate its normal production from the Sterlington plant.

[2] This allowance of $2.50 per ton for the use of the buyer's tank cars was a custom of the trade followed by manufacturers of anhydrous ammonia.

based on the market price per ton prevailing at the time of shipment F.O.B. Mathieson's plant, loaded in tank cars.

6. In 1947, plaintiff's plant at Sterlington, Louisiana, operated at capacity. The great demand for ammonia as fertilizer was the principal reason for plaintiff entering into the aforesaid contract with Mathieson. The purchasers of plaintiff's anhydrous ammonia were fertilizer manufacturers, which used the ammonia as a component element in processed fertilizer products. Use of anhydrous ammonia as a direct applicant meant that new types of customers, i.e., farmers or middlemen selling to farmers, could purchase and use the ammonia without the necessity of any intermediate processing by a fertilizer manufacturer.

7. By 1948, the market for anhydrous ammonia for direct application to the soil as a fertilizer had assumed immense proportions because of the large productivity of areas so fertilized in the growing of cotton, corn, sugar cane, rice, and certain vegetables. Plaintiff's ammonia plant at Sterlington, Louisiana, operated at full capacity throughout 1948, but was able to supply only a part of the demand from planters in the surrounding area. During the 1947-1948 years the United States supply of nitrogen was approximately 1,300,000 tons, of which 900,000 tons were used in agriculture, and 400,000 tons were used in industry. Some producers of ammonium sulphate were forced to curtail their operations because of a lack of anhydrous ammonia.

8. The market prices of anhydrons ammonia, fertilizer grade, in tank car lots, F.O.B. works, freight equalized, as

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reported weekly in *The Oil, Paint and Drug Reporter* for the years 1947 through 1949 were as follows:

From week ending—	To week ending	Reported price per ton
January 6, 1947	April 19, 1948	$59.00
April 26, 1948	July 19, 1948	$59.00-$70.00
July 26, 1948	December 6, 1948	$68.00-$70.00
December 13, 1948		$70.00-$75.00
December 20, 1948	January 3, 1949	$75.00-$85.00
January 10, 1949	July 4, 1949	$74.00-$75.00
July 11, 1949	December 26, 1949	$74.00-$75.00

9. Plaintiff's records show sales of anhydrous ammonia from Sterlington, Louisiana, for the years 1947, 1948, and 1949, by months, as follows:

	Sales—Per Ton			
	Sales, tons	Gross sales	Less: Freight absorbed by CSC	Net sales value
Year 1947:				
January	3,802	$63.35	$10.14	$53.21
February	3,993	61.52	7.44	54.08
March	5,227	62.60	6.89	55.71
April	5,451	63.03	7.58	55.45
May	4,824	64.52	9.16	55.36
June	4,665	65.31	8.81	56.50
July	5,173	66.79	9.34	57.45
August	5,128	65.15	8.58	56.57
September	4,482	64.66	7.13	57.53
October	4,833	65.15	8.13	57.02
November	4,907	66.54	8.44	58.10
December	5,856	65.84	8.02	57.82

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	Sales, tons	Sales—Per Ton: Gross sales	Less: Freight absorbed by CSC	Net sales value
Year 1948:				
January	5,381	67.29	9.08	58.21
February	4,304	65.82	7.73	58.09
March	6,152	63.52	5.07	58.45
April	5,908	63.96	5.55	58.41
May	5,814	64.30	5.85	58.45
June	5,726	59.28	.24	59.04
July	5,674	70.46	.57	69.89
August	5,498	70.78	.70	70.08
September	5,422	71.11	1.09	70.02
October	5,648	71.33	1.33	70.00
November	5,599	70.91	.99	69.92
December	5,818	74.63	.86	73.77
Year 1949:				
January	6,097	81.22	.74	80.48
February	5,085	85.13	.75	84.38
March	5,694	86.17	1.37	84.80
April	5,601	85.70	1.16	84.54
May	5,032	86.33	1.54	84.79
June	4,931	86.05	1.08	84.97
July	4,049	78.34	3.93	74.41
August	3,514	74.78	2.24	72.54
September	4,880	75.00	1.41	73.59
October	3,258	75.00	3.65	71.35
November	4,418	75.00	1.84	73.16
December	4,005	75.00	1.42	73.58

Plaintiff's sales of anhydrous ammonia were made F.O.B. Sterlington with freight charges equalized with the manufacturing location closest to destination.

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10. The minutes of plaintiff's board of directors for a meeting held November 26, 1947, contain the following resolution:

> RESOLVED that the action of the officers in executing on behalf of this Corporation a contract, dated November 10, 1947, with The Mathieson Alkali Works (Inc.), under which this Corporation agrees to purchase all the ammonia produced by Mathieson at its Lake Charles, Louisiana, plant, as qualified by certain quantity clauses contained therein, for a period of eight years commencing July 1, 1949, said contract having been submitted to this meeting, be, and it hereby is, confirmed, ratified and approved.

11. In April 1948, Thomas S. Nichols became Mathieson's president. In August of that year, the War Assets Administration approved the sale of the Lake Charles plant to Mathieson. During this period, Mr. Nichols concluded that the contract which Mathieson had made with plaintiff, prior to his becoming Mathieson's president, was an improvident and unfortunate one. He and his executive vice president, J. C. Leppart, believed that Mathieson could dispose of the output of the Lake Charles plant in other more profitable ways. Also, they desired to prevent plaintiff from dominating the ammonia market in question. Accordingly, in September 1948, Mr. Nichols contacted Mr. Henry Perry, plaintiff's president, and indicated that he desired to cancel the executory contract before it became operative. Throughout the months of September, October, November, and December, the presidents of the two companies conducted frequent discussions regarding a mutually satisfactory basis for termination of the agreement. Both plaintiff and Mathieson made independent estimates of plaintiff's projected earnings under the contract. If called as a witness at the trial in this case, Mr. Nichols would have

testified that he believed the most equitable method of terminating the contract was for Mathieson to pay plaintiff an amount which, making certain assumptions over the life of the contract, would be substantially equivalent to the profits which plaintiff would have realized under the contract; that he and others in Mathieson involved in the discussions with plaintiff negotiated the termination agreement with that concept in mind; that the amount which he and Mr. Perry finally agreed to ($2.6 million) was computed by Mathieson as the approximate profit that plaintiff would have obtained had the contract remained in effect; and that he believed that the payments totaling $2.6 million were to be spread over the period of the contract during which plaintiff would have realized profits thereunder from December 30, 1948 to June 30, 1956. Mr. Perry, who was plaintiff's sole representative in the negotiations with Mr. Nichols, died in 1950.

12. In a letter dated November 23, 1948, from J. C. Leppart, Mathieson's executive vice president, to Mr. Perry, Leppart stated: "It is my understanding that you could not claim a benefit beyond the five per cent commission stated under the ammonia contract of November 10, 1947, and certainly not the benefit of any unearned tank car allowance, and at the same time expect the contract to remain valid."

Mr. Leppart became aware that the presidents of Mathieson and plaintiff had finally agreed on a figure of $2,600,000 as the amount Mathieson would pay, and plaintiff would accept, for cancellation of the contract dated November 10, 1947. He did not know, however, how the two executives had arrived at that figure. He assumed that it represented the "best deal" the president of Mathieson could make. He did know that numerous computations were made by both plaintiff and Mathieson in an effort to estimate the profits plaintiff could reasonably anticipate

from the contractual arrangements, but variables, such as future market prices, made such calculations very difficult and unreliable. The difficulties inherent in making such computations were illustrated by a study prepared for Mathieson (after the contract was canceled) which showed 16 differing calculations of plaintiff's potential profit under 16 different assumptions. Leppart could only assume that, as a result of their conferences, the two presidents had merely arrived at a figure which suited both of them.

At the time of these negotiations, Daniel B. Curll was plaintiff's manager in charge of all production and marketing of anhydrous ammonia from plaintiff's Sterlington plant. He conferred frequently with plaintiff's president regarding Mathieson's desire to terminate the contract of November 10, 1947. Mr. Curll was opposed to cancelling the contract, and he submitted computations to plaintiff's president in support of his opinion that plaintiff could probably make a net profit from the contract of about $4,000,000. Plaintiff's president, however, was uncomfortable in the face of the determined opposition to the contract by Mathieson's new president. He felt that to insist on Mathieson's performance as an unwilling seller might well result in an "unhappy marriage," and he decided to accept Mathieson's offer to settle the matter for $2,600,000. In Mr. Curll's view, that figure did not reflect his president's opinion with respect to the possible income which might be derived from the performance of the contract. Curll believed that the president merely viewed the figure as an acceptable settlement of the matter, and that it had no meaningful relation to plaintiff's anticipated profits from the contract.

13. Based on the quantities of ammonia which plaintiff was obligated to purchase under the contract, and which Mathieson was obligated to sell and deliver, plaintiff hypo-

thetically could have received gross revenues over the life of the contract of between $3,450,600 and $3,882,750 computed under the contract as follows:

	Minimums		Estimated production level as per 1947 contract
	Buyer's obligation	Seller's obligation	
Daily tonnage	135		150
Quarterly tonnage		12,150	
Annual tonnage (365-day yr.)	49,275	48,600	54,750
Total tonnage (8 yrs.)	394,200	388,800	438,000
Average price per ton at December 30, 1948	$80.00	$80.00	$80.00
Deduct: Freight equalization	2.50	2.50	2.50
Basis for commission	$77.50	$77.50	$77.50
Commission per ton at 5%	$3.875	$3.875	$3.875
Total commission [3]	$1,527,525	$1,506,600	$1,697,250
Gross freight equalization	985,500	972,000	1,095,000
Gross tank car allowance	985,500	972,000	1,095,000
Total anticipated revenue	$3,498,525	$3,450,600	$3,882,750

[3] These gross revenue figures do not reflect the net revenue, if any, which plaintiff potentially could have realized under the contract of November 10, 1947.

14. In addition to the aforementioned revenue, plaintiff anticipated receiving revenue from railroads for the use of tank cars furnished by it at mileage rates appearing in Mileage Tariff 7C, published by H.R. Hinsch. This tariff, effective from January 1, 1948 to December 31, 1950, pro-

vided for an allowance of 2¢ per car mile, loaded and unloaded, to be paid to the shipper.

Round trip railroad short line mileage from Lake Charles to representative destinations are as follows:

Birmingham, Ala.	1,098
Florence, Ala.	1,166
Helena, Ark.	760
Piggott, Ark.	1,006
Jacksonville, Fla.	1,652
Pensacola, Fla.	914
Atlanta, Ga.	1,416
Savannah, Ga.	1,752
Chicago, Ill.	1,878
Springfield, Ill.	1,560

15. The printed financial report of Mathieson for the year ended December 31, 1948, showed the following statement as a footnote to the balance sheet:

> To assure a supply of certain raw materials during the period from July 1, 1949 to June 30, 1957, the Corporation has agreed to pay subsequent to December 31, 1948, $2,100,000.00 in installments extending over the said period.

16. Page 6 of plaintiff's printed annual financial report for the year ended December 31, 1948, showed the following statement:

> In the last year's Annual Report it was stated that arrangements had been made to secure additional ammonia for marketing beginning at mid-

1949. This additional ammonia was to become available as the result of a contract entered into with The Mathieson Alkali Works, Inc. (now the Mathieson Chemical Corporation) to buy the major portion of the ammonia produced at Lake Charles, Louisiana, in a plant leased by Mathieson from the United States Government. The contract was to run for eight years. During the past year Mathieson purchased the Lake Charles plant from the government and in furtherance of its own operations desired to be released from the contract with us. This was accomplished by an agreement to pay Commercial Solvents Corporation the sum of $2,600,000. A payment of $500,000 was received in December 1948, the balance to be received in installments over the next eight years.

17. The minutes of plaintiff's board of directors for a meeting held on December 29, 1948, contain the following resolution:

> Resolved that the President of this Corporation be, and he hereby is, authorized to execute, in the name and on behalf of this Corporation, an agreement with Mathieson Chemical Corporation (formerly The Mathieson Alkali Works, Inc.) in such form as he and counsel for this Corporation deem satisfactory, relieving Mathieson of its obligations and duties under the contract between Mathieson and this Corporation dated November 10, 1947 and providing that Mathieson shall, in lieu of all present and future obligations and duties of both parties under said contract, pay to this Corporation $500,000 upon execution of said agreement, $300,000 on July 1st of each year 1949 to 1954, both inclusive, and $150,000 on July 1st of 1955 and 1956.

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18. On December 30, 1948, Mathieson addressed a letter to plaintiff reading as follows:

> We have been discussing for some time the situation presented by the contract between our companies dated November 10, 1947, under which performance was to have begun July 1, 1949, and ended June 30, 1957. Mathieson has, since that contract was entered into, purchased the Ammonia Plant at Lake Charles which, at the date of the contract, was leased for a term expiring with that contract. Mathieson, therefore, wishes to be relieved of the obligations and duties of the contract and itself to dispose of the Ammonia production which, under the contract, would have been sold to Commercial Solvents during the term of the contract.
>
> Mathieson, therefore, submits the following offer:
>
> Mathieson and Commercial Solvents shall severally discharge and release the other with respect to all obligations and duties under said contract dated November 10, 1947, and in lieu of all present and future obligations and duties of both parties under the contract, Mathieson shall pay to Commercial Solvents the following sums on the dates specified:
>
> $500,000 immediately upon Commercial Solvents acceptance of this offer.
>
> 300,000 on July 1, 1949.
> 300,000 on July 1, 1950.
> 300,000 on July 1, 1951.
> 300,000 on July 1, 1952.
> 300,000 on July 1, 1953.
> 300,000 on July 1, 1954.
> 150,000 on July 1, 1955.
> 150,000 on July 1, 1956.

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If this offer is acceptable to Commercial Solvents, the indication of its acceptance upon the dupliicate of this letter herewith will record our agreement.

The offer contained in this letter was accepted by the plaintiff on December 30, 1948, and plaintiff received payment from Mathieson of the amounts due pursuant to the contract cancellation approximately on the dates and in the amounts set forth in the offer above.

Plaintiff had not transferred to third parties for a consideration, or released to the maker, any other contract to receive the production output or any other product purchased by plaintiff prior to December 30, 1948, or subsequent thereto.

19. Plaintiff did not receive any ammonia from Mathieson under the contract dated November 10, 1947. The contract was not included in plaintiff's inventories. Prior to the cancellation of the agreement, plaintiff neither acquired nor made any arrangements to acquire facilities for storing, transporting, or otherwise dealing with the output of the Lake Charles plant.

20. On June 15, 1949, plaintiff duly filed its United States corporation income tax return for the calendar year 1948 with the Collector of Internal Revenue for the Third District of New York. Said return showed a tax liability of $2,953,389.37, which was paid in four quarterly installments as follows:

March 15, 1949	$ 750,000.00
June 15, 1949	726,694.68
September 15, 1949	738,347.35
December 15, 1949	738,347.34
Total	$2,953,389.37

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The plaintiff included the amount of $500,000 in its original income tax return for 1948 as ordinary income. This amount represented the payment received in 1948 under the termination agreement dated December 30, 1948.

21. Thereafter, on July 13, 1951, plaintiff filed an amended United States corporation income tax return for the calendar year 1948 in which the amount of $2,100,000 to be paid in later years (as set forth in finding 18) under the termination agreement of December 30, 1948 was reported as ordinary income. The amended return showed a tax liability of $3,751,389.37, an increase in tax liability of $798,000 over the liability shown in the original return. Payment of the increase in tax liability, together with interest of $111,720 from March 15, 1949 to July 16, 1951 was made on July 13, 1951.

Attached to the front of plaintiff's said amended 1948 return was the following typewritten statement:

> All statements and schedules attached to the Federal Income Tax Return for the calendar year 1948 filed on June 15, 1949, are incorporated herein by reference.
>
> In the return filed on June 15, 1949, there was included in "Item 14—Other Income" under the heading of "Miscellaneous Income" an amount of $500,000.00 paid to the taxpayer on December 30, 1948, by Mathieson Chemical Corporation. This payment was made pursuant to an agreement entered into on December 30, 1948, whereby the taxpayer agreed to release Mathieson from its obligations under a contract dated November 10, 1947. In consideration therefor, Mathieson agreed to pay the taxpayer the sum of $2,600,000.00, of which $500,000.00 was paid upon execution of the release and the balance to be paid over a period extending to July 1, 1956.

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Recently Counsel for the Corporation has advised that particularly in view of the decision on April 6, 1950, of the United States Court of Appeals for the Seventh Circuit reversing the decision of December 20, 1948, of the District Court for the Northern District of Illinois, Eastern Division, in *Universal Oil Products Co.* v. *Campbell*, 181 F. (2d) 451 (cert. den. October 16, 1950, 340 U.S. 850 and rehearing denied November 27, 1950, 340 U.S. 894), it is their opinion that the full amount payable under the Mathieson contract should have been accrued for Federal income tax purposes in the year 1948. Accordingly, in this amended return the taxpayer has increased "Miscellaneous Income" by $2,100,000.00.

22. On June 30, 1954, within the time prescribed as the period of limitations under Section 322 of the Internal Revenue Code of 1939, as amended, plaintiff filed Claim for Refund, Form 843, with the Director of Internal Revenue, Upper Manhattan, claiming a refund of $338,000, or such additional sums as may by law be due, together with interest thereon, as provided by law. This claim for refund was prepared by plaintiff's tax manager, William H. Gilzinger, C.P.A. Attached to the claim was a statement of grounds in which plaintiff contended that the amount of $2,600,000 received and receivable from Mathieson was not ordinary income, but represented the proceeds from the sale of a capital asset held for more than six months. In pertinent part, the statement attached to the claim reads:

The taxpayer and Mathieson Chemical Corporation entered in a contract dated November 10, 1947 whereby the taxpayer obtained exclusive right to the entire production of Anydrous Ammonia manufactured by Mathieson at the ammonia plant located at Lakes Charles, Louisiana (except for ten (10) tons

per diem maximum for Mathieson's use for cylinder filling) for the period beginning July 1, 1949 and ending June 30, 1957. At the time the contract was executed, Mathieson leased the aforesaid ammonia plant for a term expiring with the contract. After the contract was executed, Mathieson purchased said ammonia plant and wished to secure for itself the unrestricted right to dispose of the ammonia production, which privilege under the aforementioned contract, belonged to the taxpayer.

In order to obtain the unrestricted use of the Lake Charles plant, Mathieson offered to purchase taxpayer's rights under the above-mentioned contract. On December 30, 1948, taxpayer executed an agreement effecting this transfer to Mathieson of taxpayer's above described rights in consideration of the payment to the taxpayer of $2,600,000, payable as follows:

$500,000 immediately upon Commercial Solvents acceptance of this order.
300,000 on July 1, 1949.
300,000 on July 1, 1950.
300,000 on July 1, 1951.
300,000 on July 1, 1952.
300,000 on July 1, 1953.
300,000 on July 1, 1954.
150,000 on July 1, 1955.
150,000 on July 1, 1956.

Included in gross income on the original return was $500,000 representing the first payment which was due under the December 30, 1948 agreement. Subsequently, the taxpayer determined that under existing U.S. income tax law, the entire amount receivable under this agreement was taxable income

in the calendar year 1948. Therefore, the amended return was filed, and therein the $2,600,000 received or receivable from Mathieson under the above agreement was reported as ordinary income, in the calendar year 1948. The taxpayer now contends that such amount represents the proceeds from the sale of a capital asset, namely the right to the entire production of the Mathieson ammonia plant, at Lake Charles, Louisiana. The taxpayer cites, as authority for its contention, the decision of the U.S. Tax Court in re: Henrietta B. Goff et al. vs. Commissioner: 20 TC—Promulgated May 29, 1953.

* * *

The said claim for refund was formally rejected by the District Director of Internal Revenue, Upper Manhattan, by Form L-60 dated December 18, 1961. Prior thereto, on June 23, 1961, the Service had transmitted Form L-70 to plaintiff, advising of the proposed disallowance of the claim which was the first written notice plaintiff received that its refund claim would be disallowed. Informal oral statements had been made to plaintiff's representatives in 1957 and 1959, indicating the probability that plaintiff's claim would be disallowed.

23. For several years prior to the rejection of the claim for refund, the District Director's office and the National Office of the Internal Revenue Service had exchanged views regarding the proper tax treatment to be accorded the transaction between Mathieson and plaintiff. There is no indication that plaintiff's representatives attended conferences, if any were held, or submitted any brief or memorandum with respect to the issues which had been referred for National Office consideration. Among those issues was the question of whether the transaction between Mathieson and plaintiff resulted in ordinary income or long-term capi-

tal gain to plaintiff and as to when the payments were deductible by Mathieson. This interdepartmental correspondence is summarized in the following finding.

24. (a) On or about May 3, 1955, the Chief, Audit Division, District Director's Office, Upper Manhattan, Internal Revenue Service, transmitted a memorandum to the Assistant Commissioner (Technical) of the National Office, setting forth all of the facts and circumstances regarding Mathieson's payments to plaintiff of $2.6 million, and requesting technical advice as to the "proper time for taking the deduction by Mathieson Chemical Corporation" and the "proper time for reporting the income by Commercial Solvents Corporation."

(b) On January 6, 1956, the Assistant Commissioner responded to the request for technical advice, ruling that Mathieson had properly claimed business deductions during the years 1948 to 1956, inclusive, for its payments to plaintiff, and that because Mathieson's liability under the cancellation agreement to make payments to plaintiff aggregating $2,600,000 became fixed and definite in 1948 with no real or substantial contingency involved, plaintiff had a fixed and unconditional right to receive such amount and, as an accrual-basis taxpayer, plaintiff should include the entire $2,600,000 in its gross income for 1948.

(c) On January 12, 1956, a memorandum originating in the District Director's office was sent to the attention of Revenue Agent William J. Trezenka,[1] transmitting the

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[1] In or about 1953, Agent Trezenka had been assigned the responsibility of examining plaintiff's income tax returns for the tax years 1944-1950. When plaintiff subsequently filed its claim for refund of 1948 taxes in 1954, it too was referred to Agent Trezenka who discussed it on several occasions with plaintiff's representative, Mr. Gilzinger. In March 1955, Trezenka had requested Gilzinger to furnish him a copy of the contract between plaintiff and Mathieson

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National Office's ruling. The transmitting memorandum stated that "[Y]ou will note that the National Office agrees with the taxpayer that Commercial Solvents Corporation should include the $2,600,000 in its return for the year 1948." The memorandum added that, since the National Office had omitted reference to the question of whether the $2.6 million represented capital gain or ordinary income to plaintiff, it could be assumed that this was an indication that it agreed with a reference made in the request for technical advice to the effect that the gain was taxable as ordinary income. The memorandum stated, therefore, that "Solvents' claim for refund filed in June 1954, predicated on the proposition that the $2,600,000 represents gain on the sale of a capital asset, should be rejected".[2] When Agent Trezenka received this memorandum, he understood that it had been prepared by the same technical advisor to the Chief of Audit who had been responsible for the initial request for technical advice. Agent Trezenka did not consider that he was bound to follow the technical advisor's recommendation on the disposition of the refund claim. Agent Trezenka told the technical advisor that he planned to keep the refund claim open to offer plaintiff an opportunity to submit a legal memorandum in support of its position. Such a memorandum was prepared and submitted by Gilzinger to the agent on November 11, 1957. It dealt

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and certain extracts from the minutes of meetings of plaintiff's board. (See findings 10, 17, and 18, *supra*.) At the time of this request, Trezenka advised Gilsinger that a ruling would be requested from the National Office as to the time of deductibility of Mathieson's payments and the time for inclusion of the payments in plaintiff's income. On March 7, 1955, Gilzinger forwarded excerpts from the board's minutes by his transmittal letter headed "Claim for Refund of 1948 U.S. Corporation Income Tax—Mathieson Contract Capital Gain."

[2] Agent Trezenka did not communicate this information to Gilzinger.

only with the capital gains-ordinary income question. However, from Agent Trezenka's testimony, it is clear that throughout the long administrative procedures involved in the examination of plaintiff's tax returns and claims for refund, he and his superiors were fully aware of the existence of two questions, namely, (1) were plaintiff's receipts under the cancellation contract capital gains or ordinary income, and (2) what was the proper time for plaintiff, as an accrual basis taxpayer, to include those receipts in its income tax returns.

(d) On June 26, 1957, the Director, Tax Rulings Division (National Office), advised the District Director's office that part of the National Office ruling of January 6, 1956, which pertained to Mathieson had been reversed. The memorandum stated that:

> Further consideration of this question has resulted in the conclusion that the total amount of the annual payments to be made pursuant to the cancellation agreement in question should be deductible by the payor corporation [Mathieson] in the taxable year in which liability to pay the entire amount became fixed and unconditional.

The memorandum added that the "portion of the ruling holding that Commercial Solvents Corporation had a fixed and unconditional right to receive the amount paid under the contract in the year 1948 still remains in effect."

(e) On July 31, 1957, the Chief of the Upper Manhattan Audit Division replied to the Assistant Commissioner's memorandum, stating that "this office is unable to accept the conclusions expressed in the memorandum of June 26, 1957." He requested very careful reconsideration of the matter and reiterated the Audit Division's final position (arrived at following considerable diversity of opinion) that the cancellation agreement between Mathieson and

plaintiff had worked "a complete abandonment" of the original contract, leaving the parties entirely to the terms of the cancellation agreement. The Audit Division contended that:

> . . . by the cancellation of the earlier agreement Mathieson not only rid itself of an allegedly onerous agreement, but obtained for itself a source of supply for the period covered by the December 30, 1948 agreement. Accordingly, assuming, but not conceding, that it could be said that on December 30, 1948 Mathieson became definitely liable for a fixed sum of $2,600,000, it acquired an asset (namely, the source of supply not previously available) and the cost thereof should be spread over the period of the December 30, 1948, agreement which covers the period of the expanded supply.

The Audit Division's memorandum went on to warn the National Office that the tax consequences contemplated by its change in position would complicate the handling of Mathieson's tax returns because of statute of limitations considerations.

(f) On December 18, 1957, the Director, Tax Rulings Division (National Office), responded to the memorandum of July 31, 1957, stating:

> The position taken in our memorandum of June 26, 1957, was based upon an opinion of the Chief Counsel . . . After appropriate reconsideration, including a conference held with the taxpayer's [Mathieson's] representatives, such position is adhered to and consideration is being given to the publication of a revenue ruling on that basis.
>
> Neither our memorandum of June 26, 1957, nor this memorandum should, however, be construed in any way as constituting instructions to your office in

the matter of the reopening of this taxpayer's case. Jurisdiction in this respect rests with your office. The taxpayer [Mathieson] should be duly advised as to your conclusions.

25. The Revenue Agent's Report covering Mr. Trezenka's examination of plaintiff's income tax returns for the years 1944 through 1950 was issued sometime in 1958. The Report did not state that plaintiff's 1948 claim for refund was to be rejected. The failure to make any reference to plaintiff's claim for refund appears to have been due to instructions received by Trezenka from his Chief Reviewer which, in effect, directed him to defer action on the claim in view of the settlement of all the so-called "standard issues" in the tax returns under examination. The purpose of these instructions was to avoid delay in submitting the Report to the Joint Committee on Internal Revenue Taxation. The long delay of approximately three years which ensued before plaintiff's claim for refund was rejected is not explained by the record, but in any event, plaintiff did not complain of the delay, nor did it file suit shortly after the expiration of six months from the date of filing the claim. Its petition here was filed December 13, 1963.

26. In its United States corporation income tax return filed for the calendar year 1949, plaintiff had included in ordinary income for that year $300,000, the amount paid it by Mathieson on July 1, 1949, pursuant to the December 30, 1948 agreement. Thereafter, on July 17, 1951, plaintiff filed a claim for refund of 1949 taxes based solely on the contention that it had erroneously included the $200,000 in 1949 income, plaintiff maintaining that such sum was instead properly includible in 1948 income. On or about May 7, 1958, plaintiff's refund claim was allowed and a refund made.

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27. In its United States corporation income tax returns for the calendar years 1950-1956, plaintiff included no portion of the payments received from Mathieson pursuant to the December 30, 1948 agreement in its income, either as ordinary income or as long-term capital gain.

Plaintiff's United States corporation income tax returns for each of the years 1949-1956 were the subject of audit. Under the provisions of Section 6501(c)(4) of the 1954 Code, plaintiff agreed to extend to June 30, 1961, the date within which deficiencies in 1949 and 1950 income taxes could be assessed against it; plaintiff also agreed to extend to June 30, 1960, the date within which a deficiency in 1952 and 1953 income tax could be assessed. The audits of the returns for the tax years 1951 and 1954-1956 resulted in a determination by the Commissioner of deficiencies in income tax for each of these years, causing plaintiff to file on July 5, 1960 and May 11, 1962, petitions in the Tax Court (Docket Nos. 87814, 1574-62) contesting the proposed increase in its tax liabilities.[6] The issues presented in the Tax Court action were in no way related to the transactions involved herein. Following the Tax Court's decision (42 T.C. 455) partially upholding the deficiencies, plaintiff appealed the case to the Second Circuit Court of Appeals. On May 26, 1965, the appeal was dismissed pursuant to a settlement reached by the parties on May 14, 1965. By virtue of the dismissal of the action, no further deficiencies in plaintiff's taxes for the years 1951 and 1954-1956 could be asserted. At the time the settlement was reached, plaintiff's representatives, the Department of Justice and the Internal Revenue Service did not know that plaintiff would thereafter amend its petition in the instant action.

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[6] The audit of plaintiff's 1953 tax return was held in suspense pending the outcome of the Tax Court case. Pursuant to the settlement of that case, a Form 870 AD for 1953 was executed by the parties on June 29, 1965.

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28. According to computations prepared by the Internal Revenue Service:

(a) Plaintiff actually paid $988,000 in income taxes by reporting as ordinary income in its 1948 amended tax return the $2.6 million periodic payments received and receivable from Mathieson.

(b) Had plaintiff treated said $2.6 million payments as ordinary income, but reported the gain as and when actually received (i.e., 1948-1956), the total income tax due on the payments for all of the years would have been $1,206,250.

(c) Had plaintiff treated said $2.6 million payments as long-term capital gain includible in 1948 income, the income tax due would have been $650,000.

(d) Had plaintiff treated said $2.6 million payments as long-term capital gain, but reported the gain as and when actually received (i.e., 1948-1956), the total income tax due on the payments for all of the years would have been $659,000.

While plaintiff accepts the accuracy of the above computations, it does not acknowledge their materiality or relevancy to this case, nor does plaintiff concede that deficiencies in plaintiff's income tax for the years 1949-1956 could now be validly assessed, or that the doctrine of equitable recoupment or the mitigation provisions (Sections 1311-1315 of the 1954 Code), would permit the collection of additional taxes for all such years.

29. From the time that plaintiff filed its 1948 amended United States corporation income tax return on July 16, 1951, until it filed its amended petition in the pending action on September 13, 1965, plaintiff's officers, employees, and representatives made no statements or representations, nor did they submit any written document (exclusive of

plaintiff's aforesaid claim for refund), to the Internal Revenue Service indicating that plaintiff intended to, or did in fact, claim a refund of 1948 income taxes on the basis of grounds as set forth in the second and third causes of action of plaintiff's amended petition.

30. In filing its claim for refund of 1948 income taxes and in pursuing the claim administratively, plaintiff did not intend to assert a position as set forth in the second or third causes of action of its amended petition as grounds for recovery. However, plaintiff asserts that the second and third causes of action are related and germane to, and stem from, the refund claim filed June 30, 1954, and encompass no new or different facts other than those stated therein, and that such facts underlie the causes of action in the original petition and in plaintiff's amended petition.

31. It was not until after June 1965, that plaintiff, for the first time since the filing of its 1948 amended United States corporation income tax return, considered asserting as a basis for recovery of 1948 income taxes the grounds as set forth in the second and third causes of action of its amended petition. However, plaintiff asserts that the second and third causes of action are related and germane to, and stem from, the refund claim filed June 30, 1954, and encompass no new or different facts other than those stated therein, and that such facts underlie the causes of action in the original petition and in plaintiff's amended petition.

Conclusion of Law

Upon the foregoing finding of facts and opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover, and the petition and amended petition are dismissed.